

NEW YORK COURT OF APPEALS ROUNDUP

INTERNAL INVESTIGATION ISSUES, ECCLESIASTICAL AND CHURCH PROPERTY DISPUTE

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NOVEMBER 6, 2008

The Court of Appeals' decision in [*People v. Kozlowski*](#), contains an interesting discussion of corporate internal investigations, cooperation with law enforcement authorities, privileges potentially applicable to material generated by counsel in conducting internal investigations, and waiver. The opinion also discusses, without resolving, an *Apprendi* issue.

We discuss that decision this month, as well as the decision in a case involving expulsion of an Episcopal parish from the Diocese of Rochester and the ensuing battle over entitlement to church property.

Tyco's Internal Investigation

The prosecution of Dennis Kozlowski and Mark Swartz, respectively the former CEO and CFO of Tyco International, attracted much public attention. The first trial resulted in a hung jury. At the second trial, defendants were convicted of 22 counts, including several counts of first degree grand larceny. At the center of the case were considerable sums of money - \$77 million in the case of Kozlowski, \$44.5 million in the case of Swartz - that the defendants claimed were legitimate bonuses approved by the compensation committee of Tyco's board, but that the jury found had been stolen from the company.

For three of the four "bonuses" at issue, there was no documentation that the compensation committee has given its approval, and every member of that committee available to testify denied having done so. Mr. Kozlowski testified that the bonuses had been verbally approved by the now-deceased former chairman of the committee. With respect to the fourth bonus, Mr. Kozlowski testified that the successor chairman had informed him that, at its October 2001 meeting, the committee approved restricted stock bonuses to defendants retroactive to June 2001. The committee, however, had not been made aware that both men had already sold the

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stock to a Tyco subsidiary in August. Thus, how much the compensation committee members knew and what they approved were key questions at trial.

Tyco initially hired Boies, Schiller & Flexner (Boies Schiller) to investigate Mr. Kozlowski's payment of \$20 million to a board member that had not been disclosed in the company's proxy statement. The retainer letter described the scope of the assignment as a review of transactions between Tyco and its directors and any related litigation. In particular, Tyco was concerned about potential shareholder derivative actions. The scope of the investigation later expanded to include defendants' bonuses and other matters.

The law firm's investigation included interviews with Tyco's directors, which were memorialized in notes and memoranda. Boies did not take notes of a critical meeting with Mr. Swartz, however, and Mr. Swartz's statements at the meeting were a subject of Boies' testimony at the trial.¹ Prior to the second trial, the defense sought copies of Boies Schiller's interview notes and memoranda. The trial court quashed the subpoena.²

Boies made a recommendation to the board, which it accepted, that the company enter into an agreement pursuant to which Mr. Swartz would resign effective immediately but continue to act as CFO until a successor was found, and receive a very substantial severance payment. Boies' discussions with the directors on that recommendation, including his description of the investigation to date, were also a subject of his testimony.

Defendants attacked the admission of Boies' testimony, claiming that it constituted prejudicial and improper opinion as to their guilt. The Court of Appeals, in an opinion by Judge Carmen Beauchamp Ciparick for a unanimous Court, disagreed. A review of the transcript revealed that the lawyer had testified only to facts concerning the law firm's investigation and his various conversations with Mr. Swartz and board members, all of which were relevant to rebut defendants' theory of the case.

Criminal Subpoenas

Of broader application is the ruling on the subpoena. The opinion first recited the standard for enforcing a third-party document subpoena in a criminal action, established almost 30 years ago in *People v. Gissendanner*:³ "defendants must proffer a *good-faith factual* predicate sufficient for a court to draw an *inference* that *specifically identified* materials are *reasonably likely* to contain information that has the *potential* to be both *relevant and exculpatory*." (Emphasis added.) The *Kozlowski* opinion reiterated that defendants are not required to show that the materials they seek are "'actually' relevant and exculpatory," just that there is a reasonable likelihood they will be.

Here, where the directors' statements concerning the bonuses bore "directly" on the question of whether they had acted in good faith, defendants made the necessary showing to be entitled to the subpoenaed material, subject to claims of privilege.

Privilege for Investigation Material

Next, the Court discussed privilege and waiver. Our readers may find it helpful to be reminded of New York's attorney privilege terminology, which differs from that of some other jurisdictions. CPLR 3101(c) provides that, "[t]he work product of an attorney shall not be obtainable." The Court observed that the drafters of §3101(c) apparently were attempting to protect attorney-client privileged materials from disclosure in distinguishing absolutely privileged "work product" from materials "prepared in anticipation of litigation or for trial," which are only conditionally protected under CPLR 3101(d)(2).

None of the parties asserted that Boies Schiller's interview materials were attorney-client privileged. The People maintained that they constituted absolutely protected work product, while the defendants argued that they constituted qualifiedly privileged trial preparation materials. The Court of Appeals agreed with the trial court that the factual portions of interview notes and memoranda were trial preparation materials, observing that "the mere fact that a narrative witness statement is transcribed by an attorney is not sufficient to render the statement 'work product.'"

The trial court found that defendants had failed to meet their burden of establishing the elements of the §3101(d)(2) test for overcoming the conditional protection of trial preparation materials, i.e., a "substantial need" because the defendants could not obtain the "substantial equivalent of the materials" without "undue hardship." The Court of Appeals affirmed, stating that it could not conclude that the trial court had abused its discretion as a matter of law.

Between the lines of the decision, however, is the suggestion that, had the judges decided the issue in the first instance, the outcome may well have been different. The opinion took note of the fact that the interviews of directors and employees are a common feature of internal investigations, as are "consult[ation]" between prosecutors and a corporation's counsel seeking to protect his or her client from criminal sanctions. It recognized that such "collaboration" may have a public benefit, but stated that it also "may come at the expense of the proper safeguarding of the rights of individual corporate employees." The Court instructed that these factors should be balanced in deciding whether to grant a defendant access to trial preparation materials under a claim of "substantial need."

Cooperation a Waiver?

Defendants next asserted that any privilege attaching to the materials had been waived. While it quoted the First Department's test from *Bluebird Partners LP v. First Fid. Bank*,⁴ that the qualified privilege for trial preparation materials is waived "upon disclosure to a third party where there is a likelihood that the material will be revealed to an adversary, under conditions that are inconsistent with a desire to maintain confidentiality," the Court of Appeals also stated in *Kozlowski* that determination of this highly factual inquiry turns on considerations of "fairness."

Of the several factual grounds for finding waiver that defendants argued, the strongest was that

Boise Schiller had cooperated with the district attorney's investigation on behalf of Tyco. There was no question that, had the law firm provided the People with written or recorded statements of witnesses, defendants would have been entitled to those statements as *Rosario* material.⁵ However, there was no evidence that Tyco's lawyers had shared even the substance of the director interviews with the district attorney's office. Again, the Court held that the trial court had not abused its discretion in finding no waiver had occurred.

Fines Under 'Apprendi'

Defendants were sentenced to serve prison time and ordered to pay restitution to Tyco. In addition, the trial court imposed fines upon Mr. Koslowski (\$70 million) and Mr. Swartz (\$35 million) under Penal Law §80.00(1). It did not hold a hearing to determine the amount of the defendants' gains, and instead relied upon facts brought out at trial. Citing [*Apprendi v. New Jersey*](#),⁶ defendants argued that their right under the Sixth Amendment's Confrontation Clause were thereby violated. Their position, however, was undermined by the fact that the relevant amounts had been established by the defendants' own trial testimony. On this point the Court stated, "[a]ssuming without deciding that an *Apprendi* violation occurred here, we nonetheless affirm because error, if any, was harmless." Resolution of the issue will have to wait for another day.

Diocese Property

A serious theological disagreement between the Episcopal Diocese of Rochester and one of its parishes led to a dispute over church membership and property ownership, as well as over the role of courts in resolving such disputes. It came before the Court in [*Episcopal Diocese of Rochester v. Harnish*](#).

The Protestant Episcopal Church of the United States of America (the National Church) has a hierarchical governing structure with a constitution and canons (church laws). In 1947, All Saints Protestant Episcopal Church applied for recognition by the Rochester Diocese, which also has canons. All Saints was accepted after it signed an agreement to abide by the constitution and canons in effect within the diocese and "conform to all the canonical and legal enactments thereof."

Following the U.S. Supreme Court's 1979 decision in [*Jones v. Wolf*](#),⁷ the Court of Appeals in *First Presbyt. Church of Schenectady v. United Presbyt. Church in the United States*,⁸ adopted Jones' "neutral principles of law" approach to property disputes, pursuant to which a hierarchical church can ensure that loyal factions retain church property. In *First Presbyterian*, the Court of Appeals stated that churches may do so either by modifying documents, such as deeds, or by creating an "express trust" pursuant to church constitution.

Shortly after *Jones* was decided, the National Church adopted the "Dennis Canons," which provided that parish property is held "in trust" for the church and its applicable dioceses "so long as the particular Parish . . . remains a part of, and subject to, this Church and its

Constitution and Canons." The Rochester Diocese followed suit with its own canon that "explicitly reaffirmed" parish property was held in such a trust.

In 2005, a theological dispute with the leadership of All Saints caused the diocese to declare that parish "ecclesiastically 'extinct,'" and direct the parish to transfer to it all real property and tangible and intangible assets. Thereafter, All Saints notified the bishop of Rochester that it had come under the ecclesiastical oversight of the bishop of Uganda. Litigation ensued.

The diocese commenced a declaratory judgment action for recognition of its entitlement to the property under the trust and for an accounting. All Saints counterclaimed seeking, inter alia, a declaration that certain provisions of Article III of the Religious Corporation Law (pursuant to which Article both entities had been incorporated) violated the establishment clause of the federal constitution. Section 42-a of Article III, upon which the diocese relied in part, authorizes Episcopal parishes to administer property "subject always to the trust in which all real and personal property is held" for the National Church and dioceses thereof. In a thorough and thoughtful opinion, Justice Kenneth R. Fisher of Supreme Court, Monroe County, granted the diocese summary judgment on its claims. The Appellate Division, Fourth Department, and Court of Appeals affirmed.

All Saints also commenced an Article 78 proceeding to annul the declaration that it was "extinct." The Court of Appeals, however, determined the diocese's decision to be a "non-reviewable ecclesiastical determination."

In an opinion for a unanimous Court by Judge Theodore T. Jones, the Court held that the Dennis Canons created an express trust that it must recognize under "neutral principles." Although All Saints had joined the Rochester Diocese before the Dennis Canons had been adopted to establish a trust over parish property, in the 20 years following their adoption the parish had neither objected to the trust provision nor attempted to remove itself from the Canons' reach. Moreover, it was "unlikely" that, in agreeing in 1947 to abide by "canonical . . . enactments," the parish had reserved the right to veto any future enactment.

The Court's decision did not rest on the Religious Corporation Law. As a result, the Establishment Clause issue should be put to rest. However, All Saints had also raised the argument that enforcement of the diocese's claim to ownership of the property would violate the due process clauses of the New York and United States constitutions, leaving open the possibility that the parish may seek further review of the matter.

Endnotes:

1. Notes and memoranda were created of other interviews of Mr. Swartz, and the factual portions of those documents were turned over to defendants.
2. During Boies' direct examination, defendants successfully moved for a production of privileged memorandum that described how his firm had uncovered one of the disputed

bonuses, on the grounds that Boies was relying upon the document for his testimony.

3. [48 NY2d 543, 550 \(1979\)](#).
4. [248 AD2d 219, 225 \(1st Dept. 1998\)](#).
5. See [*People v. Rosario*, 9 NY2d 286 \(1961\)](#).
6. [530 U.S. 466 \(2000\)](#).
7. [443 U.S. 595 \(1979\)](#).
8. [62 NY2d 110, cert. denied, 469 U.S. 1037 \(1984\)](#).